

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER UNDER REGULATION 13 (4) READ WITH REGULATION 13 (6) OF SEBI (PROCEDURE FOR HOLDING ENQUIRY BY ENQUIRY OFFICER AND IMPOSING PENALTY) REGULATIONS, 2002**IN THE MATTER OF M/S YELKAYS FINANCIAL CONSULTANTS & INVESTMENTS LTD.**

- 1.0 M/S Yelkays Financial Consultants & Investments Ltd (hereinafter referred to as 'the said broker') is registered with Securities and Exchange Board of India (hereinafter referred to as 'SEBI') as a broker - SEBI Registration no. INB 230752234 and is a member of the National Stock Exchange of India Limited (hereinafter referred to as 'the NSE').
- 1.1 During inspection of the books of account, records and other documents of the said broker undertaken by SEBI for the period April 1999 to December 2000 under Regulation 19(1) of the SEBI (Stock Brokers and Sub Brokers) Regulations, 1992 (hereinafter referred to as 'the said regulations') following violations were observed :-
- Document Register was not maintained by the said broker.
 - The said broker has delayed payment of money and delivery of securities to the clients.
 - Order Book was not maintained by the said broker.
 - Margin Money was not collected from clients.
 - Off-the-floor transactions done by the said broker were not reported to the exchange.
 - Contract notes issued by the said broker do not bear pre-printed serial numbers.
 - Client registration has not been maintained.
 - Segregation of client's account and own account was not maintained.
- 2.0 After considering the inspection report and the comments of the said broker thereon, it was decided to conduct an enquiry into the affairs of the said broker, in terms of Regulation 28 of the said regulations. Accordingly, vide order dated May 31, 2002, Shri. S.V. Krishnamohan was appointed as an enquiry officer for holding an enquiry into the contraventions by the said broker of the provisions of the rules, regulations and directives as mentioned in the said order.
- 2.1 The enquiry officer issued a show cause notice dated August 26, 2002 to the said broker under regulation 28 (2) of the said regulations. Since SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty), Regulations, 2002 (hereinafter referred to as 'the Enquiry Proceeding Regulations') commenced on 27.09.2002 the enquiry officer conducted the proceedings under the said Enquiry Proceedings Regulations.
- 2.2 After considering the reply of the said broker and submissions made on its behalf during personal hearing before him, the enquiry officer submitted the enquiry report dated October 31, 2002.
- 2.3 After considering the submissions of the said broker the enquiry officer has found the explanation of the said broker acceptable in respect of allegations regarding non maintenance of document register, delay in payment to client and delivery of securities to clients, non maintenance of Order Book and not reporting of the floor transactions to the stock exchange. In respect of the violations regarding non acceptance of margin money from the clients and non segregation of clients account and own account, the enquiry officer has found as under -
- (i). **Non collection of margin money-** it was submitted they were collecting the margin from the client by simultaneously debiting the margin amount to the clients' account and reversing the same on completion of the settlement. It was submitted that the margins were also collected in the form of shares which were valued at 50% of the market rates. It is stated in the inspection report that the broker has not collected the margin money from LKS Murty & Company.Pvt Ltd and in fact there are instances where the latter's ledger account show the debit balances continuously for months together. There is no material in support of the reply of the member that margin was always collected from them either in the form of money or shares which is in the control of the said broker. It is mandatory for member to collect margins from clients in all cases where the margin in respect of the client in the settlement would work out to be more than one lakh. The broker appears to be lenient towards L K S Murthy, in associate firm in the matter of collection of margins. Further the broker is not maintaining any record for margin money received from clients. All the money received is credited to their ledger account without any records separately for margin monies received. As seen from Annexure I to the inspection report, the member had daily margin pay-in shortages as detailed therein.
- (ii). **Non segregation of clients account and own bank accounts -** it was admitted that erroneously some cheques were issued from the clients' account and that some payments relates to LKS Murthy & Co. which is also a registered client with them.

It is noticed that the show cause notice cites 30 instances where certain expenses like telephone, electricity were paid from the client's bank account. The total of this expenditure is between 26/5/2000 and 23/2/2001 is Rs.1,14,379/-

It was contended that some of the payments were on account of LKS Murthy & Co. who is also stated to be a client of the member. While this may be so, there is no justification for these payments from the client's account as these payments do not arise out of securities transactions. It is admitted by the member that erroneously certain cheques were issued from the client's account.

Debiting of clients' account for the transactions which are not client related defeat the very purpose of maintaining clients' account separately. The amounts to the credit of clients' accounts are in the nature of trust and the member is not in order in meeting other expenses which are not client related from such account. The funds in the client's account cannot be applied for any purpose other than what is permissible under SEBI Guidelines. The objective of opening and maintaining a separate account for the client's funds is to segregate and identify them separately and to prevent its misuse so that they are beyond the reach of the broker. The broker has met certain office expenses from the client's account which is highly irregular. This is in violation of SEBI Circular SMD/SED/CIR/93/23321 dated 18th November, 1993.

- 2.3 In view of the facts and findings as recorded in the enquiry report, the enquiry officer in terms of Regulation 13 (1) b) of Enquiry Proceedings Regulations recommended that the certificate of registration of the said broker be suspended for a period of four months.
- 3.0 The enquiry report was considered and in terms of Regulation 13(2) of Enquiry Proceedings Regulations, a show cause notice no. SMD/DBA-I/Enq/AM/23768/2003 dated December 04, 2002, was issued to the said broker enclosing therewith a copy of the enquiry report calling upon it to show cause as to why the penalty as recommended by the enquiry officer should not be imposed upon it. It was also advised to reply to the same together with the documents if any, that it may choose to rely upon in support of its reply, within 15 days of the receipt of the same, failing which it would be presumed that it has no explanation to offer. The said broker was also advised to intimate its desire of personal hearing along with its reply. The said show cause notice was served through the NSE on the said broker.
- 3.1 The said broker vide its letter dated 20.12.2002 submitted its reply and sought personal hearing in the matter. The said broker also submitted that M/s. LKS Murthy & Co (Pvt.) Ltd is a company with 100% holding by Krishnamurthy S. Lokkur (50%) and L.S. Tarabai (50%) and that some of the payment from the client account has happened when the firm was not active in the market and the balance in the client account was also not pertaining to any client. It has further submitted that it assures that in future the lacunae pointed out will not be repeated and it will take maximum precaution in not mixing the client account with other expenses account. It requested to condone the lapses as pointed out in the show cause notice.
- 3.2 The said broker was granted an opportunity of personal hearing on 11.01.2003. However, the said broker sought adjournment on the said date and accordingly an another opportunity of personal hearing was granted to the said broker on 27.02.2003. On the said date Mr. Krishnamurthy L.S., Whole time director of the said broker appeared on behalf of the said broker. He reiterated the earlier submissions and requested that a lenient view may be taken in the matter.

4.0 Findings –

- 4.1 I have taken into account the findings and recommendations of the enquiry officer as contained in the enquiry report, the oral and written submissions of the said broker and the relevant material available on record. After considering the same I agree with the findings of the enquiry officer. In respect of the violations found in the enquiry report, I find as under -
- A. **Non collection of margins** – I find that the said broker has not submitted any explanation in respect of this violation in its reply dated 20.12.2002. the enquiry officer has clearly established that the said broker has not collected margin money from LKS Murthy and Co Pvt. Ltd. and there were instances when the latter's ledge account show the debit balances continuously for months together Margins are imposed by the exchange/ SEBI as an important tool for risk containment measures. Collection of margins as prescribed by SEBI guidelines is a risk containment measure which should be strictly adhered to. As per SEBI Circular no.SMDRP/Policy/Cir-35/98 dated 4.12.98 it is mandatory for the stock brokers to collect margins from clients in all cases where the margin in respect of the client in the settlement, would work out to be more than Rs.50,000/-. The margin so collected is required to be kept separately in the client bank account and utilized for making payment to the clearing house for margin and settlement with respect to that client. Vide circular no.SMDRP/POLICY/CIR-7/2000 dated 4.2.2000, the requirement of collecting margins in respect of the client in a settlement, was increased from Rs 50,000/- to Rs.1,00,000/-. Thus, in all cases where the margin in respect of a client in a settlement would work out to be more than Rs.1,00,000/-, the member brokers shall have to mandatorily collect the margins from the client. I agree with the findings of the Enquiry Officer and hold that the said broker has violated this requirement of collecting margin from the clients.

B. Non segregation of clients account and own account –

I observe that the said broker has not been able to establish that it has not misused the clients' account. The show cause notice cited 30 instances where certain expenses like telephone, electricity were paid from the client's bank account. The total of this expenditure between 26/5/2000 and 23/2/2001 is Rs.1,14,379/-. There was no cogent reply or explanation from the said broker that it had maintained proper segregation of the clients account and its own account as specified by SEBI circular no. SMD/SED/CIR/93/23321 dated November 18, 1993 and regulation 6.1.4 read with regulation 4.4.12 NSE Capital Market Regulations – Part A (hereinafter referred to as 'the NSE Regulations'). I find that the said broker has admitted this said violation. I find that the said broker has violated the requirements as stipulated in circular no. SMD/SED/CIR/93/23321 dated November 18, 1993 and the above mentioned NSE Regulations. By the said circular the SEBI has specified the norms regarding Regulation of Transactions Between Clients and Brokers and it has been made compulsory for all the brokers to keep the money of the client in a separate account and their own money in a separate account. Further, it has been stipulated that no payment for transactions in which the member broker is taking a position as a principal will be allowed to be made from the clients account. Regulation 4.4.12 of the NSE Regulations provides that in addition of guidelines issued by SEBI relating to the Regulation of Transactions between Clients and Brokers, the member shall at all times keep the monies of the constituent in a separate bank account. Regulation 6.1.4 (b) of the NSE Regulations provides that it shall be compulsory for all trading members to keep the money of the clients in a separate account and their own money in a separate account. No payment for transactions in which the trading members is taking position as a principal will be allowed to be made from the clients account by the above mentioned circular and regulation 6.1.4 (c) it has been further provided that no money shall be drawn from clients account other then money properly required for payment to or on behalf of the client for or towards payment of a debt due to the member from the clients or money drawn on client's authority or money in respect of which there is a liability of clients to the trading member. Vide circular no. SMD/MDP/CIR/043/96 dated August 5, 1996 it has been directed that in case of deficiency in having separate bank account for clients but not segregating clients funds from the own funds by the brokers, a serious view will be taken.

I find that the said broker has committed the violation as observed in the inspection/enquiry report and has used the clients money towards the expenses like telephone, electricity etc which is clearly in violation of the SEBI circular and the NSE Regulations.

- 4.2 In terms of rule 4 of the Securities and Exchange Board of India (Stock Brokers and Sub-Brokers) Rules, 1992, the Board may grant a certificate to a stock-broker subject to the following conditions inter alia that he shall abide by the rules, regulations and bye-laws of the stock exchange or stock exchanges of which he is a member. As found hereinabove the said broker has violated the NSE Regulations. Therefore, I find that the said broker has violated the condition of the certificate of registration as provided in rule 4(b) of the SEBI(Stock Brokers and Sub-Brokers) Rules,1992.
- 5.0 In view of the above observations I find that the said broker is guilty of having violated the provisions of clauses A(5) of the Code of Conduct as specified in Schedule II read with Regulation 7 of the Regulations and Rule 4(b) of the SEBI (Stock Brokers and Sub-brokers) Rules, 1992, SEBI directives contained in the circulars and the NSE Regulations as found hereinabove. In view of the same, the said broker is liable for action under regulation 13 (1) (b) of the SEBI Enquiry Proceedings Regulations.
- 5.1 Under section 11 of the SEBI Act, SEBI can take measures to protect the interests of investors and to regulate the securities market inter alia by registering and regulating the working of stock brokers. The directives contained in the SEBI circulars are the measures for regulating the working of the stock brokers. Further, the Code of Conduct specified in Schedule II of the said regulations also provides for the minimum standards for the working of the stock brokers. If the regulatory requirements are violated by the stock brokers without attracting any action, the measures taken by SEBI for regulation of the stock brokers would be rendered nugatory and the regulatory function would be jeopardized. The requirements regarding margin collection is provided as a measure of risk containment and to provide for transparency and fairness in the transactions.
- 5.2 It is to be noted that indulgence of the said broker in the transactions which are prohibited can not be allowed on the ground of any technicality or otherwise especially when such transactions are likely to have a detrimental effect on regulation of the securities market. Further, every stock broker is under obligation to comply with the provisions of the Act and the Rules and Regulations made thereunder as also the circulars and guidelines issued by the Board from time to time. It is also imperative that all the members of the stock Exchange shall adhere to the bye-laws of the Exchange.
- 5.3 Regulation 7 of the said Regulations provides that the stock broker holding the certificate shall at all times abide by the Code of Conduct as specified in Schedule II. Further, Clause A (5) of Schedule II provides that a stock broker shall abide by all the provisions of the Act and the Rules, Regulations issued by the Government, the Board and the Stock Exchange from time to time as may be applicable to him. Regulation 4.5.1 of the NSE Regulations provides that the trading member shall at all times subscribe to the code of conduct as prescribed by the SEBI (Stock Brokers and Sub-brokers) Regulations, 1992.

5.4 I find that the said broker has committed violations as observed above and has not taken due care and diligence in observance and compliance of the statutory requirement in conduct of its business as a stock broker. I find that the said broker has violated the condition of registration specified in rule 4 (b) of the SEBI (Stock Brokers and Sub-brokers) Rules, 1992. I find that the penalty as recommended by the enquiry officer may be reasonable in terms of regulation 13 (1) (b) (ii) read with regulation 13 (6) (b) of the Enquiry Regulations. Looking into the violations committed by the said broker, I am satisfied that it is necessary to secure the proper management of the stock broker and also in the interest of the securities market that a penalty of suspension of certificate of registration for a period of four months is reasonable. Therefore, in exercise of the powers conferred upon me by virtue of sub section (3) of section 4 of the Securities and Exchange Board of India Act, 1992 read with regulations 13 (4) and 13 (6) of SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 I hereby order that the certificate of M/s. Yelkayes Financial Consultants and Investments Limited registration no. INB 230752234, a member of the National Stock Exchange Limited, be suspended for a period of four months.

6.1 This order shall come into effect after three weeks from the date of this order.

DATE 2nd May, 2003

PLACE : MUMBAI

G.N. BAJPAI

CHAIRMAN

SECURITIES AND EXCHANGE BOARD OF INDIA